



Redefining internal audit

Local Government





Table of contents

Introduction	2
Internal audit	4
Foreword	6
Key messages	8
Nature of provision	10
Audit plans	11
Assurance mapping	14
Use of data analytics	17
Case study – Payroll Expenditure	19
Staffing	20
Feedback mechanisms	22

Introduction

Internal audit represents one of the key sources of assurance for local authorities throughout the country. Alongside external audit and other sources of assurance, internal audit provides management and Members with an assessment of the effectiveness of governance and control arrangements, enabling them to make informed decisions and develop action plans to deliver improvements where necessary.

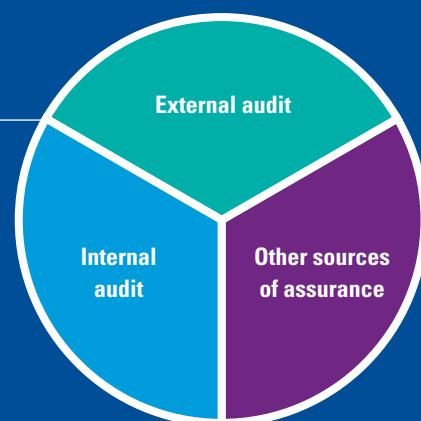
This report seeks to provide an oversight of the current status of the provision of internal audit services in the local government sector. It also highlights those areas where there is the potential to redesign delivery models in order to increase the value that internal audit providers can add to their clients.

Our findings are presented across six key themes:

- The nature of provision adopted;
- The way in which audit plans are structured and have changed over recent years.
- The adoption of assurance mapping;
- The use of data analytics;
- Internal audit staffing and skills; and
- Feedback mechanisms adopted



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- Service to Management & Audit Committee
 - Internal, external or co-source
 - Considers risk management, internal control and governance
 - Assurance and Consulting activity
-



Approach

Using publically available information published on authority websites, we have collated detailed information in relation to the volume and content of internal audit plans over a three year period.

We undertook a survey relating to the way in which internal audit operated throughout the sector. This was distributed throughout the sector and included Unitary Authorities, Single Tier Councils, Police, Fire Authorities, National Park Authorities and Passenger Transport Executives.

Based upon the results of our data collation and survey, we held interviews with a number of Finance Directors and Heads of Internal Audit in order to gain a more personal insight into the challenges facing the delivery of internal audit in the sector.

Internal audit

Internal audit can guard against the risk of financial savings while making its own

Internal audit can guard against the risk of financial savings while making its own

The case for excellent internal audit is never stronger than during a period of financial austerity. "If you turn off the taps of funding, change the way you operate your governance, your control environment, your service delivery, then naturally the organisation's senior management and its members have a greater assurance need," argues Tim Cutler, Partner at KPMG. "Change gives risk, and gives a need to monitor and to provide reassurance."

His conclusion is simple: "If I was a finance director, a chief executive, a chair of audit committee, I would be thinking internal audit is increasingly important to me – it's one of my ways of monitoring my risk profile."

It is a powerful argument, and there is an irony at its heart. "Like any other part of local government, internal audit cannot be immune to financial austerity. It has got to find cost savings like everyone else," he says.

Safeguarding the safeguarders

The result is two priorities which appear to be mutually incompatible. How can one safeguard against the risks of financial cuts if it is necessary to cut some of the safeguarding?

KPMG research suggests the issue is one being grappled with up and down the country. Over the last three years, two thirds of local authorities have seen the scale of their internal audit plan reduced as a result of funding cuts.

It is a stark reality, but not without possibilities according to Tim. "Internal audit can respond to financial challenges positively," he emphasises. "It's about focusing those audit days on the areas of greatest risk and with the greatest assurance need – targeting the work where it's going to give you the biggest bang for your buck, basically."

Avoiding duplication

One important way to do this is through assurance mapping. This involves building a record of all the assurance sources available to local authorities – both internal and external. In this way, it is possible to reduce duplication of work, as well as to identify areas where assurance is currently lacking.

Despite the clear benefits of assurance mapping, a KPMG survey suggests its current use is limited. Only half of the local authorities surveyed said they undertook such a process, and Tim suspects the true figure could be even lower. "Our own knowledge of working with the local government sector suggests even those who said they're doing it aren't really doing it to a full extent. I don't think many would say, hand on heart, we have a fully functioning, proper assurance mapping process which is comprehensive and effective."

While he admits assurance mapping can be a complicated process, he emphasises it does not necessarily need to be so. "It's one of those how long is a piece of string things. You can keep digging until the sun goes down, and there'll always be something else out there you can find.

But really conceptually at heart it's quite simple, which is identifying the areas in which you think you have something which is relevant, make sure you've got mechanisms to communicate and coordinate and consolidate all those things, and then have your internal auditor thinking about the outputs of them."

He says this is quite a different way of working to that which has gone before. "Assurance mapping is not something that's historically been done. Internal auditors were internal auditors, that's what they did, they had a plan, they delivered work, they went on to next year's plan. External regulators did other things, advisors did other things, and we never really pulled them together."

The need for board-level support

Changing that necessitates board-level involvement, he suggests. "Where assurance mapping happens, and where it happens most effectively, is where there's someone in the organisation at a senior level who sponsors the concept and tasks people with coordination."

That board-level understanding is equally helpful when it comes to using data and analytic techniques in auditing: another area of real potential, according to Tim. "Data analysis is a huge opportunity, very high profile within audit community. And I think the key point for senior leaders is not to write it off as something expensive which only IT specialists can do with clever systems which we don't have."

The power of data

Simple tools like Excel are often sufficient to “flip on its head the work an auditor does, the coverage and scope that you get, and the comfort and assurance you can give,” he explains. “A traditional internal auditor will audit a particular area by using a relatively small random sample. Data analytics allows the entire dataset to be in the analysis. So you’re getting positive comfort and assurance on the entire population of data.”

Again, KPMG research suggests few local authorities are currently capitalising on this opportunity. Just seven per cent of respondents said data analysis was a routine part of their approach to internal audit. Three quarters said its use was minimal or non-existent.

Tim is keen to emphasise another key statistic from KPMG’s research: that three quarters of those surveyed said they were generally very satisfied with the service offered by internal audit. It speaks to the extent to which strong services are still being provided despite challenges. Yet the extent to which services could be strengthened further still is equally clear. And there could not be a more important time at which to do it.



Foreword



Tim Cutler

Partner
Local Government
KPMG in the UK

As a firm specialising in audit services to the local government sector, we have seen first-hand the changes required to respond to the funding reductions faced by Authorities over the last five years. The impact of these changes cannot be underestimated. Even where CSR announcements are more moderate than expected, funding reductions are set to continue and further change will be necessary. In light of the result of the EU Referendum, the level of uncertainty is likely to increase at least in the short term. This creates a heightened need for vigilance over an authority's risk profile in order to ensure that there is appropriate consideration of the changing landscape of local government.

Internal audit is not and should not be immune from change in the face of austerity or transformation, but it also has a role to play in supporting the wider Authority in how it can assess the impact of change and better understand risk in the future. Internal auditors need to evolve alongside the services that they review. A key part of this is through adopting elements of best practice, be that from the local government sector or in the wider internal audit market.

As a firm which invests heavily in the evolution of audit in a multitude of sectors, at KPMG we are keen to support this change. We have produced this report to set out some of the key challenges – and opportunities – that we believe local government internal auditors are facing. The report draws upon the results of a recent survey of local government Finance Directors, Heads of Internal Audit and Audit Committee Chairs, along with interviews and online research, to visualise and better understand the way in

which internal audit teams are responding to these challenges.

The research identified some clear themes which local government internal audit teams need to focus on in the future – these themes form the structure of this report:

- Ensuring internal audit work is targeted sufficiently at the areas of greatest risk and assurance need, and is appropriately co-ordinated with other assurance mechanisms (Audit Plans; Assurance Mapping);
- Developing auditing techniques and staff skills that provide value to both management and Members, but which also maximise the efficiency and impact of audit work and the level of assurance provided through modern techniques that go beyond traditional sample testing and work in a more intelligent, informed and risk based manner (Use of Data Analytics; Staffing); and
- Ensuring that internal auditors accurately assess and understand their own performance and the way they are perceived by their clients (Feedback Mechanisms).

As authorities seek to improve their systems and processes, internal auditors must do the same. It is only by seeking to evolve themselves, as the authorities that they serve must also evolve, that internal auditors can deliver services that are of true strategic value and benefit. Key to this is ensuring that audit work is focused on those areas which will make the greatest difference and on those service areas where failures would have the most significant impact on the delivery of strategic objectives.



Key messages

Nature of Provision

42% 

Just under one half of all authorities have some form of in-house internal audit provision.

19% 

Only **19 percent** of authorities have a fully outsourced internal audit service. This is significantly lower than generally found in other public sectors.

39% 

Over a third of authorities use consortium internal audit providers which are seen as providing access to improved benchmarking and best practice examples.

Audit Plans

66% 

Over the last three years, two thirds of authorities have seen the scale of the internal audit plan reduced as a result of funding cuts.


18% 

A comparison of internal audit plans over a three year period show an average reduction of **18 percent** in the number of audit days.

Risks 

75 percent of authorities indicated that in response to these reductions they had increased the focus on strategic risks.

Assurance Mapping

50% 

Only **50 percent** of authorities are currently attempting any form of assurance mapping model.

5% 

5 percent of authorities indicated that the links between their strategic risks and the work of internal audit are weak.

All 

Despite this, **100 percent** of authorities indicated that their strategic risks are covered by the work of internal audit on at least a cyclical basis.

Use of Data Analytics

Data

There is an increasing focus on the use of data analytics, and the way in which this can increase audit efficiency, throughout the audit market.

76%

However, **76 percent** of authorities indicated that they have only minimal or no usage of data analytics within their current internal audit provision.

Cost

Whilst there are initial costs incurred in the development of data analytics, the long term benefits are expected to exceed this.

Staffing

IT

Only **43 percent** of authorities indicated that their internal audit teams included in-house IT specialists, with **16 percent** had no access to such skills.

HoIA

All of the authorities surveyed confirmed that their Head of Internal Audit possessed qualifications relevant to their role.

43%

43 percent of authorities indicated that their internal audit staff consisted of a minimum of **50 percent** qualified professionals

Feedback Mechanisms

77%

Over three quarters of authorities are still to undertake the mandatory external assessment of compliance with the Public Sector Internal Audit Standards.

Time

Many authorities are delaying the assessment to allow change to embed. The deadline for completing this is 31 March 2018 so it may be at risk of being missed if not scheduled soon.

89%

Customer satisfaction surveys undertaken by internal audit providers indicate that at the vast majority of authorities the service provision is seen as highly satisfactory.

Nature of provision

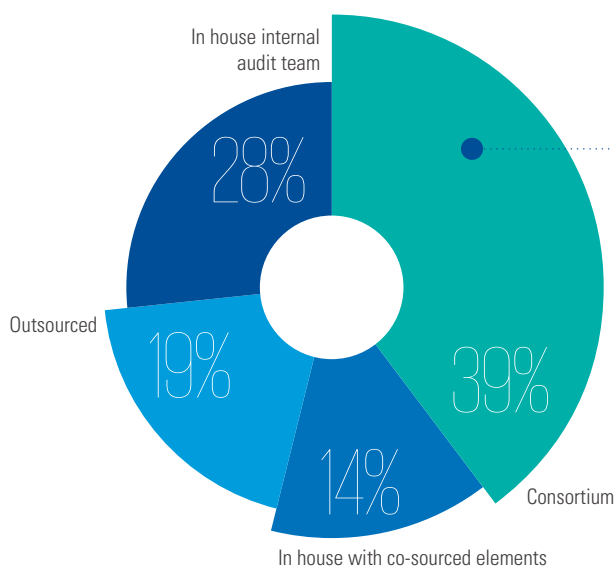
Two thirds of the respondents to our survey indicated that their internal audit service was by way of either an in-house team or a consortium (this includes both shared in-house audit teams and audit teams that have been transferred out to purpose built external companies providing services to a number of local authorities). These delivery models help to ensure that audit staff have a detailed understanding of the way in which local authorities work as well as the specific operations of the authorities that they serve. In contrast however, their ability to benchmark performance against the larger public sector practice, and specifically against commercial enterprises, can be limited due to the size and nature of their client base.

Less than one fifth of respondents used a fully outsourced model with this being more common at small authorities and police bodies. This represents a significant difference to many other parts of the public sector, for example the Health and Education sectors, where there is typically a significantly higher reliance upon outsourced services. To some extent this may reflect the scale of traditional local authority plans and the need to maintain sufficient in-house capacity in the internal audit team to deliver this volume of days. Where an outsourced model is adopted we generally see a reduced scale of audit, but one which is highly focused upon the risks facing the organisation to maximise the value of the resources allocated.

Audit Committee Question Prompts

- How can you best structure the provision of your internal audit service to provide the required level of independent technical expertise?
- Are there any areas of specific technical expertise which are not currently covered by the internal audit staff skill mix?
- How does the authority ensure value for money is achieved when procuring internal audit services and any additional expertise required?

Provision type



"From the Council's perspective the biggest benefit of this is the synergies that are created and the facilitation of knowledge sharing and benchmarking."



In relation to a shared service with smaller entities one council stated that "the main gain is for the other bodies as they gain access to a larger service. There is a benefit of gaining assurance over the use of monies granted by the Council to such entities though".



Our survey results indicated of those authority's using a co-sourced model, 88% were securing their IT expertise through outsourcing.

Audit plans

Over the last 6 years, the local government sector has borne a significant portion of the savings required as a result of the central spending reviews. This has necessitated significant changes in the way that authorities operate and the way that they deliver services. Internal Audit has not been immune to these changes and the level of funding available to deliver the audit programme has frequently been cut back.

In many cases this funding reduction has necessitated a change in how internal audit is delivered. Potential responses included:

- Reducing the staff cost base – This creates a risk that either the resource base will be insufficient to deliver the audit programme, or that staff are not sufficiently experienced to provide real value.
- Reducing the extent of the audit plan –

Whilst this allows for the level of work required to be reduced in line with savings in staff costs, it also reduces the breadth of areas covered.

- Designing more efficient delivery models – This allows for the reduction in assurance to be minimised, but it can take significant time and initial investment in order to develop such models.

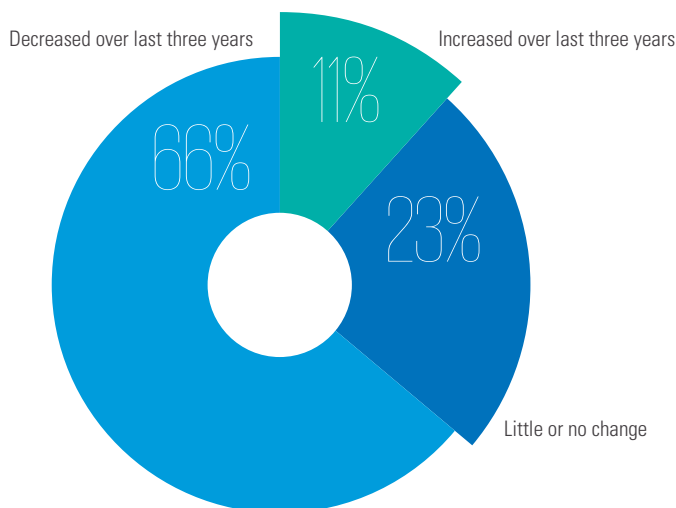
The vast majority of authorities have, at least in the short term, opted to accommodate the required level of savings by way of reducing the size of the audit plan. This approach need not have a negative impact on the overall level and quality of assurance provided to the audit committee if it is combined with a more risk based focus when planning the audit work for the year.



Based upon our web research, the average number of total internal audit days fell by 8% from 2013/14 to 2014/15 and a further 10% from 2014/15 to 2015/16.

Despite this, the average number of days per £'m of revenue has increased slightly from 3.4 to 3.6 over the same period. This may be representative of the speed with which funding has been reduced and the ability of authority's to respond at the same rate.

Volume of work



The majority of respondents (63%) indicated that they did not expect any further reduction in the immediate future. Just over one quarter (28%) however expected further significant reductions whilst only 9% expected an increase in the volume of work.

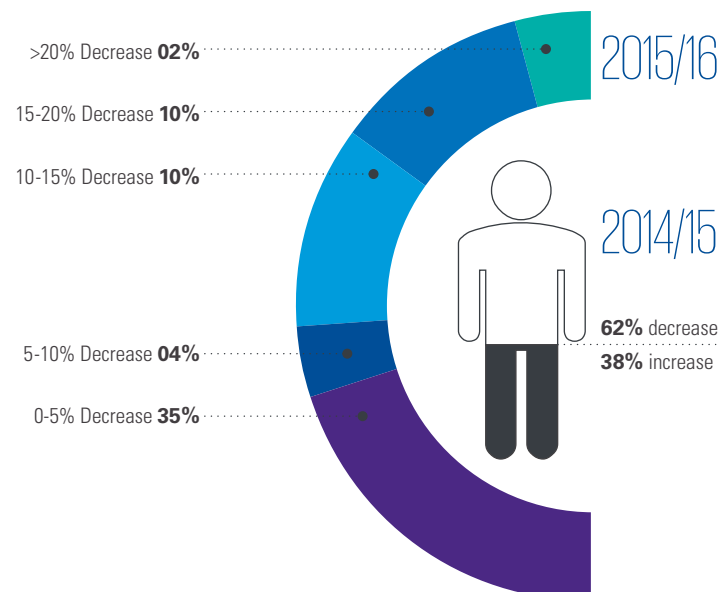
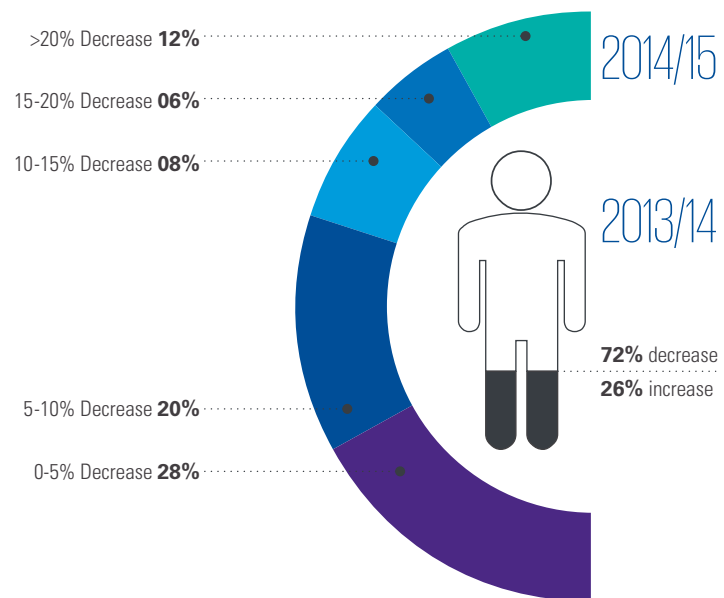
Audit Plans cont...

Whilst the average reduction in the number of days included in internal audit plans over the last two years has been 8% and 10% respectively, the impact upon individual authorities has varied greatly. From 2014/15 to 2015/16, 22% of authorities saw a reduction of over 10% whilst in the prior year 25% saw this level of reduction. In contrast, over a quarter of authorities have increased their audit plans in at least one of these years.

Audit Committee Question Prompts

- Has any reduction in the scale of the internal audit plan impacted upon the quality and extent of assurance provided?
- Are your strategic risks adequately reflected in the internal audit plan?
- Can your internal audit service deliver improved efficiency and more targeted audit focus?
- How is the authority going to accommodate further funding reductions in relation to their impact on the internal audit service?

Change in audit days



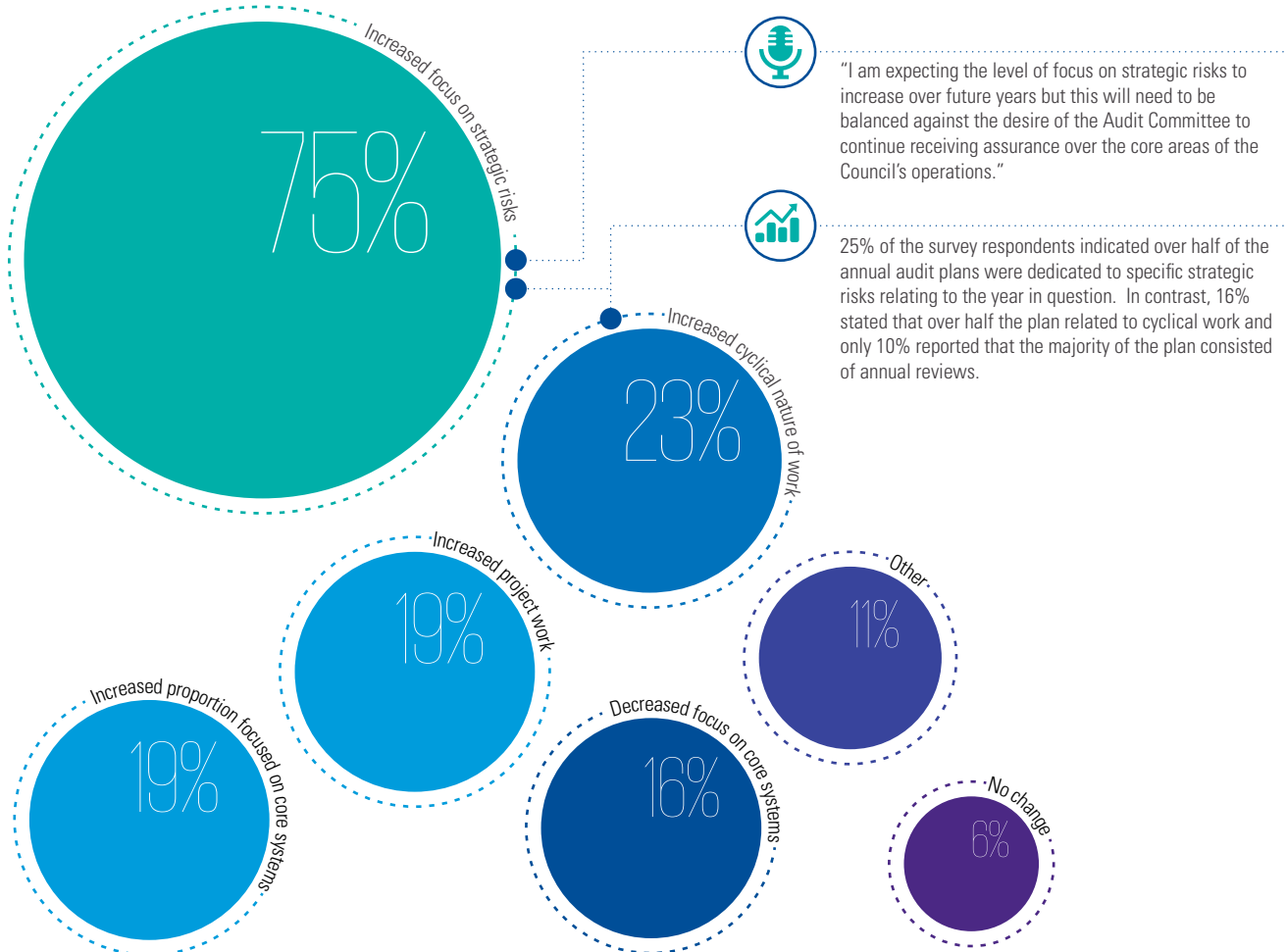
As indicated earlier, the funding reductions imposed upon local authorities has generally resulted in a reduction in the size of annual audit plans. In order to accommodate this, authorities have also been required to reassess the focus of internal audit work in order to maximise the value of the assurance they are receiving.

The way in which individual authorities have sought to reshape their internal audit services has differed depending upon the willingness to reduce the extent of assurance provided over individual areas of operation. The vast majority of authorities indicated that at least part of this response related to increasing the focus of the internal audit

service on the key strategic risks facing the organisation.

This change allows for the increasingly limited resources to be focused upon those areas where assurance is needed most to ensure that strategic objectives are delivered.

Reshaping internal audit plans



Assurance mapping

Whilst internal audit represents a key source of assurance to Members and management, it is not the only source of assurance available. Indeed, there are a wide range of assurance sources available to authorities including both internal and external processes, controls, and entities. In order to achieve greatest value for money, there is a need to understand the various assurance sources that are in place and how they interact with each other.

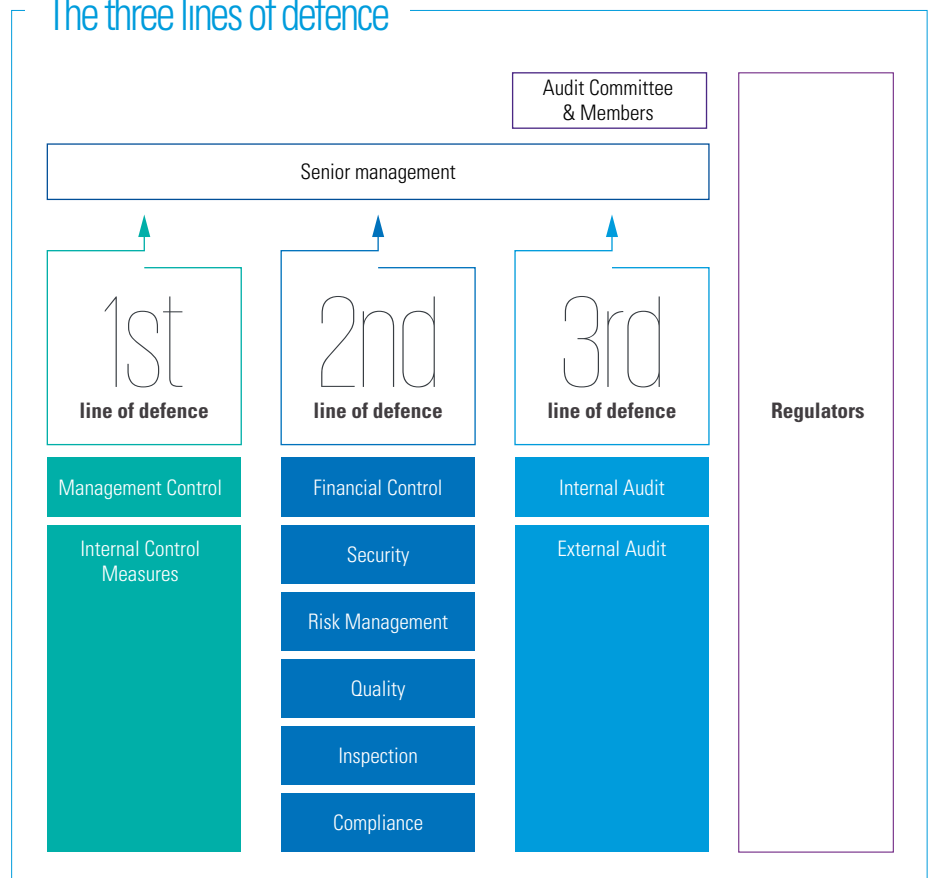
The “Three Lines of Defence” model helps identify the range of assurance sources available to an entity. An Authority’s own internal controls form the first line of defence against risk. The effectiveness of these controls is then subjected to monitoring by the second line of defence consisting of the authority’s internal quality control and compliance processes. The third, and final, line of defence is Internal Audit and can offer independent assurance over both the first and second lines of defence.

Effective assurance mapping is essential to ensuring that management and Members are aware of the way in which they are receiving assurance in relation to key areas of operations and over significant risks. In order to achieve this there needs to be an effective risk management process in place upon which assurance mapping can be built.

This delivers a clear understanding of those risks which are of greatest importance and in relation to which there is a need to monitor assurance processes. Having developed this, authorities can then begin to identify and record the assurance which they receive over these risks.

Despite the significant benefits of assurance mapping, only half of the authorities surveyed indicated that they undertook any form. Further to this, of those that did, a quarter failed to use it in the development of the internal audit annual plan.

The three lines of defence



As a result of this, there is a risk that audit resources are being inefficiently directed to those service areas where the authority has already established adequate assurance processes from other sources.

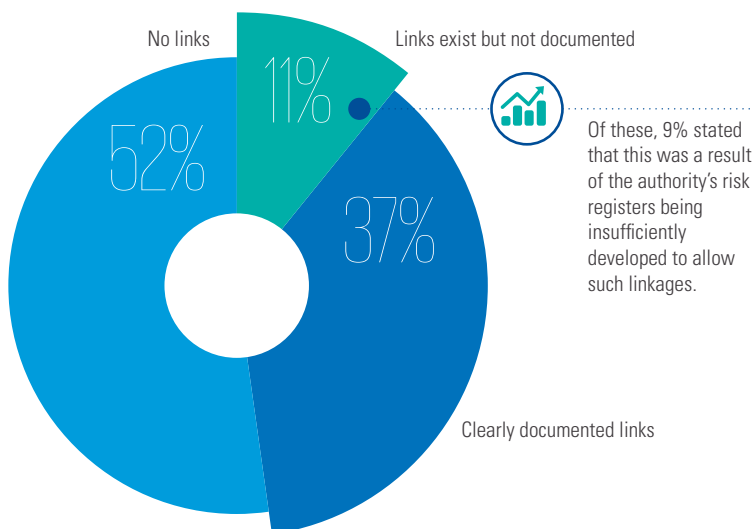
An example of this is housing benefits. Whilst internal audit could undertake an in-depth review of the benefits service, including sample testing of claims, many authorities will already have a quality review team covering this area. As a result, internal audit may be more appropriately instructed to assess the adequacy of the work undertaken by the quality team. This follows the three lines of defence model, with the third line providing assurance over the second, which in turn provides assurance over the first.

Coupled with assurance mapping, individual elements of the internal audit plan should be linked to key strategic risks so as to make it clear how the service is aligning with the authority's assurance needs. Whilst 89% of survey respondents stated that such linkages existed in their audit plans, only 37% confirmed that these links were clearly documented. The majority of those authorities with no such linkages indicated that this was a result of failings in the risk register. Such weaknesses also undermine the ability to develop effective assurance mapping.



Assurance mapping cont...

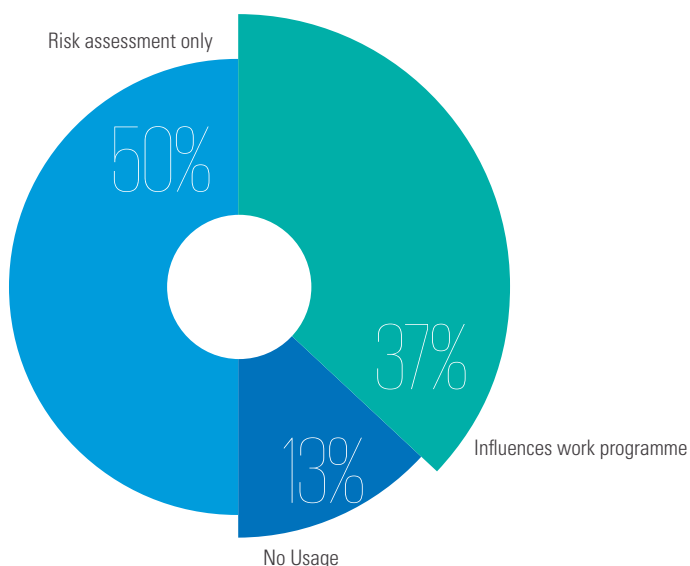
Links to key risks



Audit Committee Question Prompts

- How effective are your internal risk management processes and to what extent do you understand the various sources of assurances available to you?
- Have you established a formal assurance mapping process which is used to identify any assurance gaps and ensure that internal audit is focused in the most effective manner?
- Does the internal audit annual plan take account of the other sources of assurance which are open to the authority?
- Are individual internal audit reviews aligned to the authority's key areas of strategic risk?
- Are you aware of the various assurance sources operating within the authority and do you receive appropriate reports as to the results of their work?

Assurance mapping



Use of data analytics

Recent years have seen a significant increase in the focus on the use of data analytics throughout both internal and external audit provision. This has seen a shift away from large volumes of sample testing in favour of intelligent analysis of complete populations in order to identify those areas which, based upon an understanding of expected business practices, warrant detailed investigation.

We believe that the adoption of data analytics enables an appropriate balance to be secured between the value of audit outputs and the level of audit effort required to deliver those outputs. This is a balance that has historically been challenging to achieve.

The main benefits of increased use of data analytics include:

- **Precision** – data analytics provides for a higher level of precision in audit procedures which in turn leads to more valuable insights.
- **Integration** – through integrating data collection routines and processes into an Authority's existing systems the level of disruption is reduced.
- **Trends** – Access to a broader range of data facilitates the identification of meaningful patterns and provides actionable intelligence that matters to an Authority's business.
- **Insights** – Detailed analysis can uncover the business reasons behind issues and isolate the root cause of outliers and anomalies.



Use of data analytics cont...

Despite the additional value that can be gained through the use of data analytics, only 7% of survey respondents indicated that it had become a routine part of their approach to the delivery of internal audit. Over three quarters of responding authorities indicated that the use of data analytical procedures was minimal or non-existent.

For many authorities, there are two key challenges to the adoption of data analytics as an alternative to more traditional auditing techniques. The first of these is the experience and skills of current audit staff in relation to such procedures. Data analytics represents a significant change in the way that audit services are delivered. As a result, additional training is likely to be required.

The second key challenge is that there is an initial investment required in order to develop the data collection and analysis processes which underpin this model of delivery. This is especially true in relation to older information systems which may not enable the large scale extraction of data in a user friendly format.

There is, however, some degree of misconception in relation to data analytics around the idea that it requires costly new software tools. Whilst purpose built software tools are available, and can greatly facilitate the

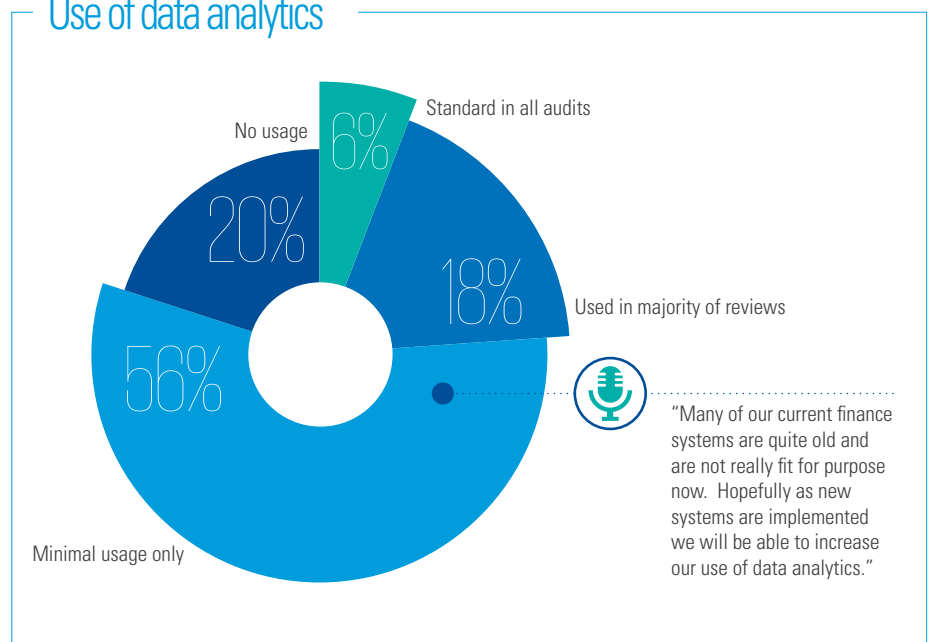
analysis of data, it is also possible to make use of software packages that authorities already have access to, such as Microsoft Excel. By providing additional training on the more complex functions of these software packages, authorities can begin a wider adoption of data analytics without the need to invest in costly software.

Whilst the challenges facing full implementation of data analytics may require initial investment, this should be viewed in light of the long term benefits that will be secured. The adoption of data analytics not only offers a greater level of assurance, but provides the opportunity to increase efficiency and ensure that audit resources are focused upon those areas where the highest risk of failings arises.

Audit Committee Question Prompts

- What barriers exist to the successful implementation of data analytics at the authority and how can these be removed or overcome?
- Which areas of the authority's operations do you feel could benefit most from the adoption of data analytics as a model for the delivery of internal audit?
- How could the adoption of data analytics be used to increase the long term efficiency of the internal audit service and maintain the level of assurance provided despite funding reductions?

Use of data analytics



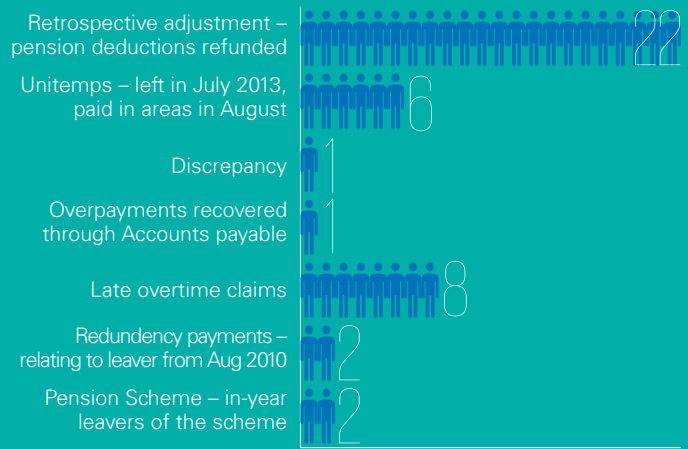
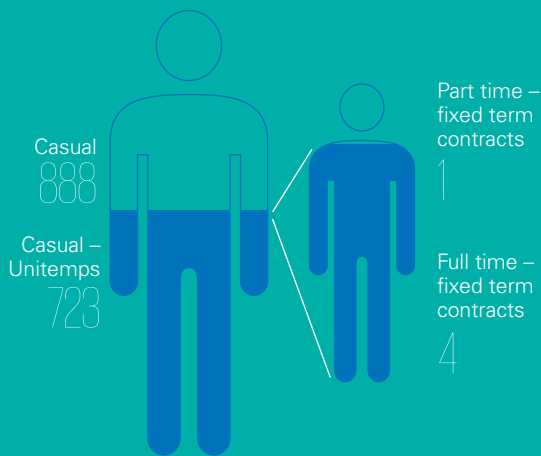
Case study - Data Analytics

Case Study - Payroll Expenditure

Data analytics routines can provide detailed assurance over the effective operation of systems and controls (such as those around starters and leavers). This can be achieved through the comparison of related data sets in order to identify inconsistencies.

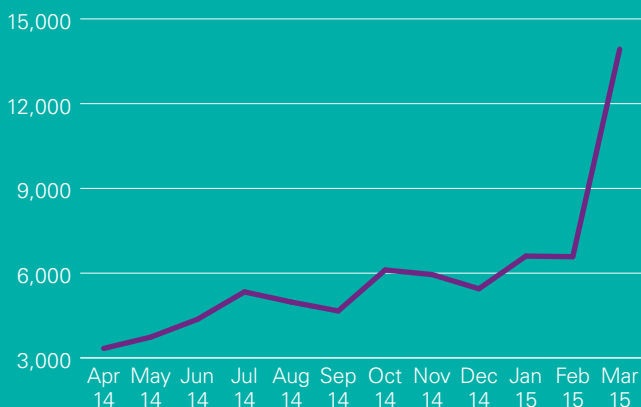
Employees on HR staff list but not paid in the year **1,616**

Employees on transaction file as paid but not on HR master list **42**



Case Study - Journals

Through the analysis of large amounts of data, valuable insights can be gained into the financial activities of the organisation.



Journals posted on weekends and bank holidays	
Total number of journals	7,396
Total debit value of journals	£4,412,019,839.78
Total number of journals posted by users on weekends and bank holidays	23
Journals posted on weekends and bank holidays as a proportion of total journals (by number)	0.30%
Total value of journals posted by users on weekends and bank holidays	£5,051,889.92
Journals posted on weekends and bank holidays as a proportion of total journals (by total value)	0.10%

Staffing

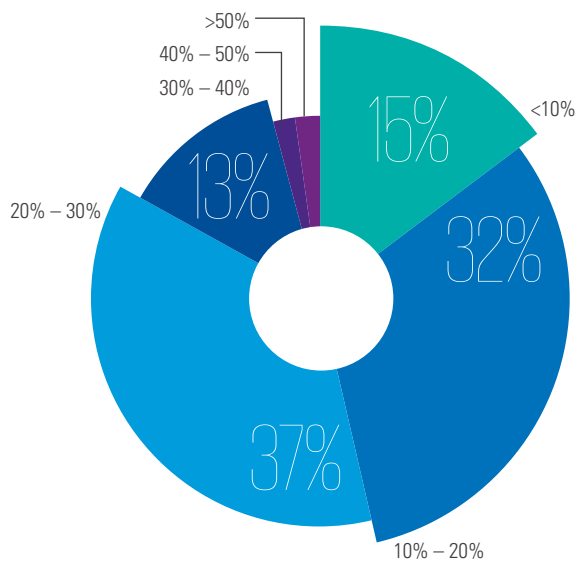
The size of internal audit teams is relatively small, with 47% of authorities indicating that the internal audit team consisted of five or fewer full time equivalents and only 15% indicating that the team consisted of over ten. This reflects, at least to some extent, the prevalence of in-house internal audit teams which are dedicated to the provision of services to single authorities.

Despite the small sizes of some audit teams, the split between management and non-management appears to be at an appropriate level, with only 17% indicating that over 30% of the staff were in management positions. There were, however, 2% of respondents who indicated that over half of the internal audit team were in a management position. This related to very small internal audit teams, however.

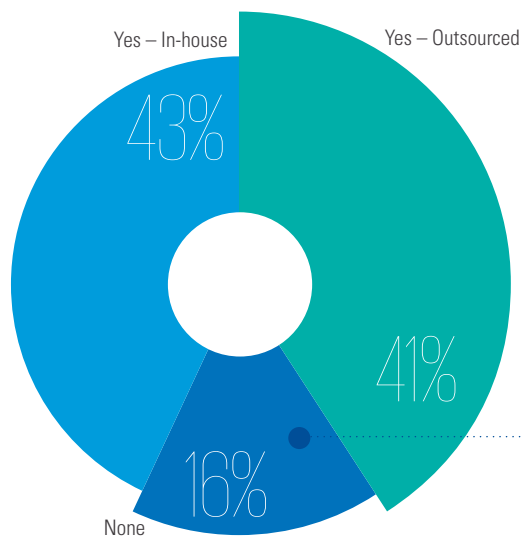
Maintaining an appropriate split between management and non-management will form an essential part of controlling staff costs and responding to funding reductions. It is, however, essential to maintain adequate management resource to ensure efficient oversight and governance.

Only 43% of respondents indicated that they had access to in-house IT expertise to support the completion of IT related audits. Just under one fifth of respondents stated that they had no IT expertise in any form. This is an area of significant risk given the increased reliance that authorities are placing upon IT systems and the growing prevalence of large scale integrated systems. In order to maintain the level of assurance required, authorities are likely to need to address this skills shortage within the near future.

Management proportion



IT audit expertise



"We don't have any IT specialists in-house and so far none of our IT audits have been sufficiently technical to require them."



Based upon our survey results, all Heads of Internal Audit have a relevant qualification to support the delivery of their role, with 67% holding CCAB membership. This is in line with our expectation and represents a clearly positive message for the sector.

In addition, the level of qualifications held by audit team is also relatively high, with 43% of authorities indicating that over half of the audit team consists of qualified accountants. There are still, however, a number of authorities who indicated that only a minority of staff were formally qualified.

The challenge for authorities moving forwards will be two-fold:

- It may be increasingly difficult to maintain this level of qualification as ongoing funding reductions continue to create the need to shrink staff costs.
- The drive towards increase risk based audit, and the adoption of data analytics, will result in changes to the desired skill mix in internal audit teams.

The effective management of these factors will be key to ensuring that the quality of provision is maintained.

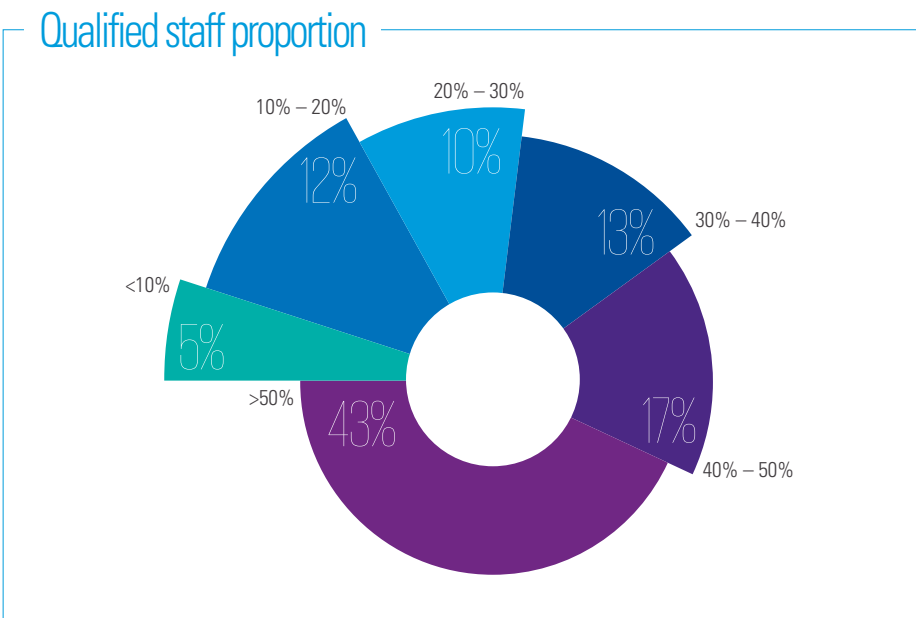
From our interviews, we identified that many authorities do not currently operate a qualification programme on an ongoing basis. This reflects the fact that many of the internal audit teams have been consistent in terms of membership over recent years (subject to reductions in staffing levels). This is likely to need to be reconsidered in future years as authorities seek to recruit new staff, or train existing staff, in order to facilitate changes in the nature and focus of work.

Internal audit providers will need to carefully monitor and assess both the existing skills mix and the required areas of expertise in order to ensure that they are capable of meeting the demands of individual authorities and delivering the level of service required.

“Many staff currently only have an AAT qualification which they have allowed to lapse. I would expect this to change though as we move to a more risk based approach and the maintenance of qualifications becomes more critical.”

Audit Committee Question Prompts

- How are you ensuring that internal audit staff are appropriately qualified and receive the right level of training going forward to support the delivery of the internal audit plan?
- How does the internal audit provider identify the required level of training and the appropriate staff mix?
- What areas of specialist skill are required to deliver your internal audit plan and are you confident that such skills are available?
- To what extent is the authority reliant upon automated controls incorporated within IT systems and what level of assurance are you receiving in relation to these controls?



Feedback mechanisms

The Public Sector Internal Audit Standards (PSIAS), effective as of 1 April 2013, require that internal audit providers are subject to external assessment of their compliance with those standards. This assessment should be undertaken at least once every five years with action plans being developed to address any identified area of deficiency. At the time of conducting our survey, however, only 23% of respondents had completed the assessment.

This assessment is a valuable indicator of the quality of the internal service and provides a clear indication of any individual areas where further improvements could be achieved. As such, we would expect it to be seen as a valued tool for internal audit providers, audit committees and management. Despite this, the result of our survey and interviews indicated that this was not always true and that some authorities were questioning the benefit to be obtained in comparison to the costs involved.

In contrast to this, our view is that when properly structured and undertaken, the external assessment will provide stakeholders with a detailed evaluation of the internal audit service. This will allow for any deficiencies in PSIAS compliance to be identified and appropriate action plans developed. Compliance with the PSIAS is not just a formality, it is a key driver towards ensuring a high quality of provision and the delivery of an internal audit service that adds real value to authorities' control environments.

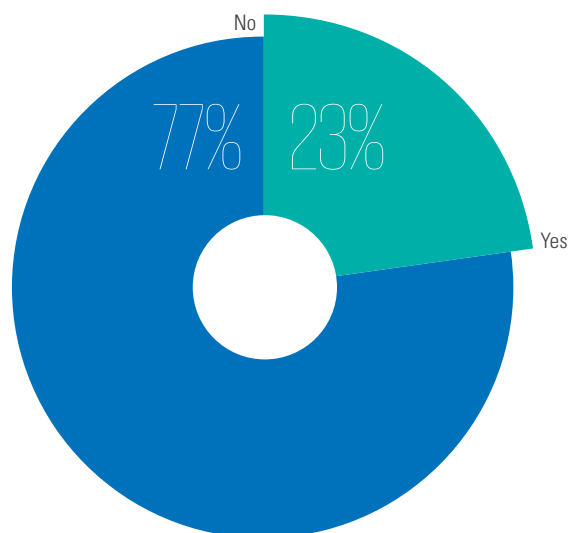
In order to ensure that the external assessment is of real value to individual authorities it is essential that it be:

- **Comprehensive** – In order to gain greatest benefit, the review should consider all elements of the PSIAS requirements and provide an honest assessment of the extent to which compliance has been achieved.
- **Pragmatic** – The recommendations coming out of the assessment must be workable and reflect the way in which the authority wishes to operate. There is no “one shape fits all” approach to internal audit and as such the external assessment must remain flexible.
- **Independent** – The assessment must be free of any bias (including perceived bias) to ensure that it provides the audit committee and management with appropriate and reliable assurance over the way in which the internal audit service is operating.

Of those authorities who have completed an assessment, 77% have opted to undertake this through a reciprocal arrangement consisting of a group of internal audit providers reviewing each others procedures. We understand that CIPFA have confirmed that this is an acceptable approach, although our view is that other approaches may provide more robust challenge. A key factor to consider here is the size of the pool of providers involved in the review. Where this is limited in number there is an increased risk that, at least from a perception basis, the desired level of independence may be eroded.

Of those authorities that have undertaken an external assessment, two thirds reported that the results indicated that no elements of non-compliance had been identified.

External assessment undertaken



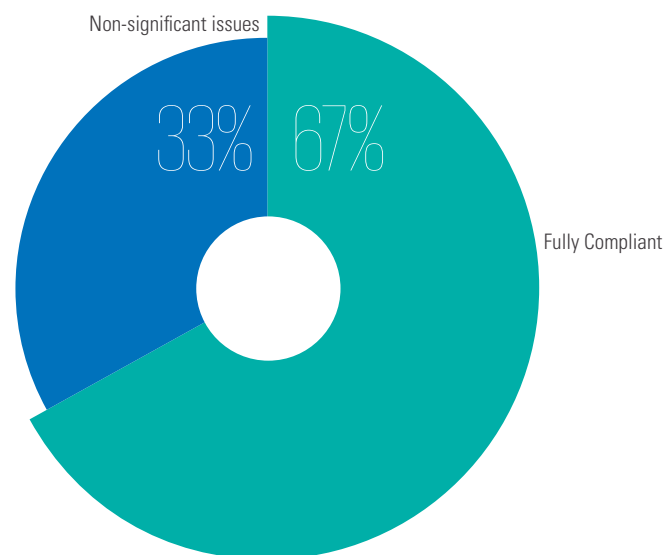
The remaining authorities indicated that only minor areas of non-compliance were identified. Given our own experience of local authority internal audit services, we would have expected a higher rate of non-compliance, especially during the first few years of PSIAS application. Whilst this is a welcome indication of the general high quality of internal audit provision in the sector, it is possible that the low number of issues identified is indicative of the assessments being undertaken with a lower level of critical scrutiny than we may have expected.

The identification of areas on non-compliance, especially in the first external assessment, should not be seen as indicative of a fatal flaw in the internal audit service. We would anticipate that some non-compliance would exist at many authorities and that the external assessment provides a summary of these so that appropriate actions can be taken.

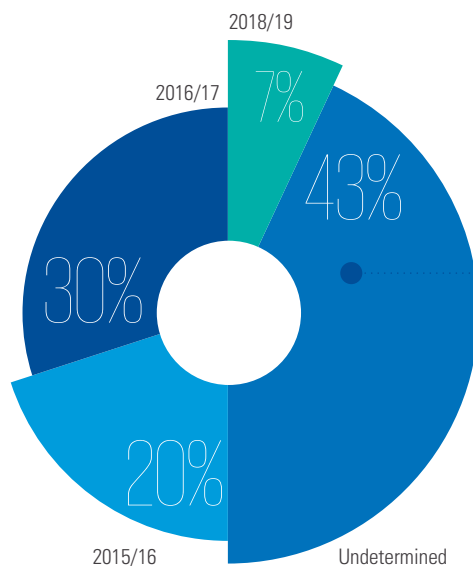
Of those authorities who had not undertaken an assessment, 43% had not yet determined when it will be undertaken. This in part reflects a desire to allow for new processes to become more fully embedded before they are formally tested.

Whilst this is an understandable desire, it is essential that authorities determine a timescale for the completion of these external assessments to prevent them being delayed indefinitely. Authorities are now into the third year of PSIAS application, and there is only a limited amount of time left in order to undertake the assessment in line with the required frequency of once every five years.

Results of assessments



Timing of future assessments



"We are delaying the external assessment as long as possible in order to allow us to fully embed the requirements of PSIAS but also because we are unsure as to how much benefit will be obtained"

Feedback mechanisms cont...

The formal external assessment of PSIAS compliance is only one measure of the effectiveness of the internal audit service and, to some extent, does not directly consider the way in which the service is viewed by the authority it serves. In order to gain an understanding of performance in this area, 89% of the survey respondents indicated that they undertake periodic customer satisfaction surveys.

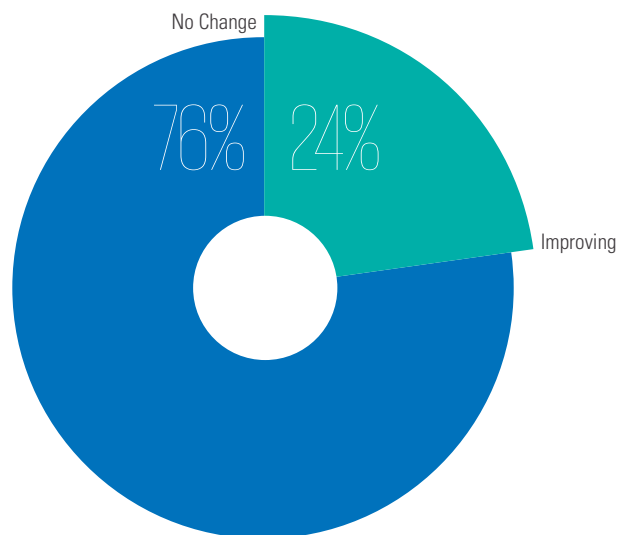
Whilst the exact nature of these surveys will differ between authorities, the aim is to gain an understanding of the way in which the internal audit is perceived and the extent to which it is meeting the expectations of its "customers". One of the key challenges however, is how to ensure the objectivity of responses so that the internal audit service can develop appropriate improvement plans.

Our survey results indicated that the level of satisfaction is currently very high, with 89% reporting that the average outcome was "very satisfied" and no authority indicating overall dissatisfaction.

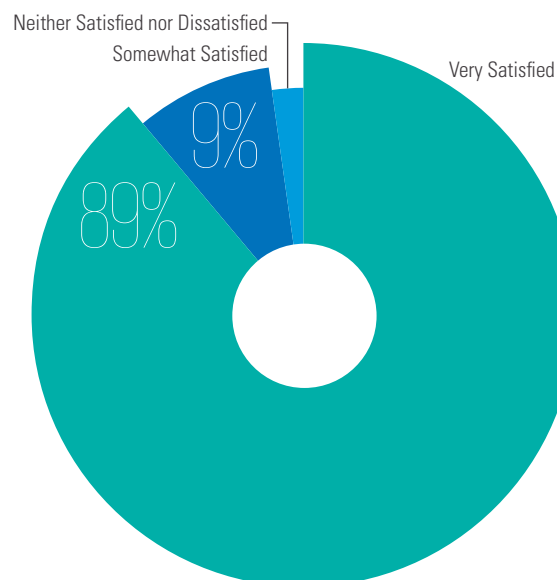
Our survey results also indicated that the levels of satisfaction have improved over the last three years for just under one quarter of authorities, with the remaining respondents indicating no change.

This improvement in satisfaction ratings may reflect the increased focus upon strategic risks resulting in officers feeling that the internal audit service provided a more relevant and valuable level of assurance. By focusing directly on these key risk areas, internal audit is more able to support officers' work and offer information which is of greater immediate utility and import

Progress made



Level of satisfaction



One council indicated that they were reducing the use of customer satisfaction surveys indicating that "the results are not of great use as they are frequently based upon personal preferences rather than objective measures."



Audit Committee Question Prompts

- What do you want to achieve through the external assessment of your internal audit service's compliance with the Public Sector Internal Audit Standards?
- When will this assessment be undertaken and are you comfortable with that timing?
- How will you ensure that the external assessment provides the authority with an output of real value?
- Are you happy that the external assessment is being undertaken in an independent and object manner?
- How will you ensure that enhancements recommended as a result of the external assessment are appropriately implemented and that these result in service improvements?
- How can the authority collect, and react to, customer satisfaction data in a manner which facilitates constant improvement in service delivery?

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